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JAPAN AND SOVIET FAR EAST DEVELOPMENT

Summary

Japan's cooperation in the development of the Far Eastern part of the Soviet Union often has been presented as assistance that could result in mutually beneficial returns. Joint development of the region's vast untapped natural resources potentially could benefit Japan, which is dependent on imported industrial inputs, while the Soviet Union, or more specifically the region itself, could acquire much-needed technical expertise and capital from Japan.

Although several joint resource development programs were launched in the 1970s, the high cost of development as well as the next decade's troubled international political atmosphere made further cooperation difficult. Also complicating bilateral economic ties was the Northern Territories dispute. Tokyo conditioned financial and technical help for the Soviet Union to movement on this issue, and that linkage discouraged Japan's private sector from greater involvement in Soviet Far East economic development.

Although Soviet President Mikhail Gorbachev's "new thinking" diplomacy resulted in dramatic changes in the international political arena, only minimal progress has been made on the territorial dispute. Moreover, the business climate in the Soviet Union has worsened over the last year or so as the demise of the communist regime has brought about both political and economic chaos.

Wary Japanese companies have responded coolly to Moscow's requests for expanded private-sector help. Although several billion dollars worth of development projects and a number of joint

business arrangements are under consideration, corporate Japan views support from Tokyo as a prerequisite for broad private-sector participation in the Soviet Far East's economic development.

Moscow's and Tokyo's Perspectives on Siberian Development

The Soviet Union,[1] especially Siberia, is endowed with one of the world's richest reserves of natural resources, spanning oil, natural gas, coal, nonferrous metal ores and various other minerals as well as forestry and marine resources. To date Moscow has put a priority on developing the resources and the industries of Western Siberia, which is close to the more populated areas of the country. Oil and gas development, for example, mostly has taken place in the Urals and Western Siberia. Pipelines connect drilling sites there with major industrial cities in the western part of the country; some pipelines extend as far as Western Europe.

Despite its vast natural resources, the eastern part of the country remains undeveloped. Transportation between east and west is a problem because it depends heavily on a single railroad. The combination of an undeveloped infrastructure, a harsh climate, a limited labor force and remoteness from industrial centers drives up resource development costs in Eastern Siberia and the Far East Soviet region. One researcher has estimated that, compared to the national average, construction costs alone run two to eight times higher there, while additional infrastructure, such as housing and roads, cost 10 times more and labor costs are 1.7 to 7 times higher.[2] Moreover, despite wage incentives, few workers and their families have settled in the eastern part of the country. Given these circumstances, development of the region appears a somewhat low priority of Soviet economic planners. As Soviet President Mikhail Gorbachev pointed out in a speech in Vladivostok in July 1986, "The region's share of all-union production [was] not only failing to increase but even falling."[3]

Development of Eastern Siberia and the Far Eastern area of the country requires enormous financial commitments and human resources that the Soviet Union cannot afford to provide on its own. In the past economic planners in Moscow have suggested that cooperation with East Asian countries, particularly Japan, would be a realistic way of facilitating development. These countries

[1]Despite uncertain political developments that have changed the name and the makeup of the country formerly named the Soviet Union, this report will use the term Soviet Union for consistency's sake.

[2]Estimate by Victor Mote, cited in Sumiye O. McGuire, Soviet-Japanese Economic Relations (Santa Monica, California: Rand Corp., May 1990), pp. 37-54.

[3]"Text of Speech by Mikhail Gorbachev in Vladivostok, 28 July 1986," translated and provided by BBC Morning Service.

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not only could help supply the necessary capital and technology but would provide markets for the exploited resources. Outlining Moscow's first comprehensive policy for Soviet Asia in his Vladivostok speech, Mr. Gorbachev stressed the necessity of cooperation with Japan and other Asian countries to accelerate economic development in Siberia and the Far East region.

From the Japanese point of view, however, participation in Siberian and other Far East development is not as attractive a picture as the Soviet leader might hope to paint. The huge cost of development projects and their high-risk nature always have discouraged Japanese investors, even though Japan's business community long has acknowledged the potential benefits of diversified international sources of industrial and agricultural input supplies. The confusion and uncertainty increasingly gripping the Soviet economy over the last year or so has made Japan's private sector even more cautious. Also of concern is the estimated $500 million that the Soviets already owe for purchases of Japanese-made products (see JEI Report No. 29B, August 2, 1991).

Moreover, since big resource development ventures anywhere require sophisticated technology and often have to be backed up by official credit arrangements because of the the risks involved, an investor country's business sector tends to be sensitive to the political climate. Japan's economic relations with communist countries have fluctuated in recent years depending on the international political atmosphere; that has particularly affected extension of official credits and exports of high technology-related products. Although the recent dramatic changes in the political system of the Soviet Union portend a favorable climate in East-West relations over the long run, a too rapid and too uncertain transformation of the political system -- accompanied by dissolution of the Union of Soviet Socialist Republics -- has jeopardized the business atmosphere in the short term. Companies seeking to invest in the Soviet Union now not only have difficulty finding a reliable business partner but equally are hard-pressed to settle on a responsible government entity in control of business activities.

Japanese investors have the added worry of their country's claim for the return of four islands north of Hokkaido -- Shikotan, Kunashiri, Etorofu and the Habomai group -- that the Soviet Union has occupied since the end of World War II. The Northern Territories dispute has impeded full government support for the private sector's business dealings with the Soviet Union. Since Tokyo considers the prospect of Japanese financial and technical assistance for the Soviet Union as one of its very few bargaining chips in resolving the territorial impasse and negotiating a peace treaty (see JEI Report No. 18A, May 10, 1991), the government has taken pains to remind Japanese businessmen that any further commitment to Siberian or Soviet Far East development might undermine Tokyo's leverage.

Joint Development Programs in the 1970s

The early 1970s marked an exceptionally active period for postwar Japan-Soviet economic transactions. Japan's exports to the Soviet Union multipled almost fivefold between 1970 and 1975, while purchases from that country expanded 2.4 times (see Table 1). As a sign of the somewhat erratic year-to-year trade since then, the $5.9 billion value of 1990's two-way trade was only 2.1 times higher than the total in 1975.

Table 1: Japan's Trade with the U.S.S.R., 1970-91

(in millions of dollars; exports f.o.b., imports c.i.f.)

Year	Exports	Imports	Balance
1970	$341	$481	$-140
1975	1,626	1,170	456
1980	2,778	1,860	918
1981	3,259	2,021	1,238
1982	3,899	1,682	2,217
1983	2,821	1,456	1,365
1984	2,518	1,394	1,124
1985	2,751	1,429	1,322
1986	3,150	1,972	1,178
1987	2,563	2,352	211
1988	3,130	2,766	364
1989	3,082	3,005	77
1990	2,563	3,351	-788
1991 (January-September)	1,587	2,518	-931

Source: Japan Tariff Association

In the 1970s Soviet state entities and Japanese business consortia initiated several large-scale joint development projects backed by official loan agreements, including oil and gas exploration, production of logs and lumber as well as wood chips and pulp, port construction, and coal mining (see Table 2). These projects had a number of features in common. To make up for the Soviet Union's shortage of capital, especially the scarcity of hard currency reserves, the Export-Import Bank of Japan extended a loan to the pertinent Soviet state entity, which used the money to purchase machinery and equipment for a specific project from Japanese suppliers. The Japanese business consortium involved in a project agreed to import industrial inputs resulting from the development, like logs or coal, under long-term contract. Revenue from these exports was used to repay the Ex-Im Bank loan. Coordinating each project was the Japan-Soviet Business Cooperation Committee, which Keidanren (Japan Federation of Economic Organizations) and the Japan Chamber of Commerce and Industry set up jointly with a Soviet group comprised of the Soviet Ministry of Foreign Trade, state trade organizations and the Soviet Chamber of Commerce and Industry.

Several factors prompted the Japanese government and industry to participate in these projects: energy concerns related to the 1973-74 oil shock and political developments involving Japan-U.S. relations as well as U.S.-Soviet relations. Japan's industrial structure at the start of the 1970s was skewed toward such energy-intensive products as steel and chemicals. Over 70 percent of the country's FY 1970 energy requirements were met by oil, most of which was imported from the Middle East by multinational oil companies (see JEI Report No. 33A, August 24, 1990). Government and industry reacted to the first oil shock by scrambling to find alternative sources of energy supplies and implementing a variety of energy-conservation measures. Oil and gas development projects in Siberia and the Soviet Far East were seen as capable in the long run of helping to achieve the diversification objective, even though initial costs would be high. From that long-term perspective several business leaders, including the heads of Keidanren and JCCI, represented the Japanese business community in promoting joint development programs.

Table 2: Major Japan-Soviet Development Projects in Siberia and Soviet Far East

Project	Period	Japanese Imports	Japanese Exports	Export-Import Bank Credit Line
First Forestry Resource Development Project	1969-73	Logs: 7,600,000 cubic meters Lumber: 420,000 cubic meters	Sawmill equipment, transportation equipment and consumer goods	Supplier's credit: $163 million
Second Forestry Resource Development Project	1975-79	Logs: 17,500,000 cubic meters Lumber: 900,000 cubic meters	Sawmill equipment, transportation equipment and consumer goods	Buyer's credit: $550 million
Third Forestry Resource Development Project	1981-86	Logs: 12,000,000 cubic meters Lumber: 1,240,000 cubic meters	Sawmill equipment, other machinery and transportation equipment	Buyer's credit: $1 billion
Fourth Forestry Resource Development Project	1992-96	Logs: 6,000,000 cubic meters Lumber: 400,000 cubic meters	Sawmill equipment and transportation equipment	None (cash basis)
First Wood Chip and Pulp Development Project	1972-81	Chips: 8,050,000 cubic meters Pulp: 4,700,000 cubic meters	Sawmill equipment and consumer goods	Buyer's credit: $50 million
Second Wood Chip and Pulp Development Project	1986-95	Chips: 8,200,000 cubic meters Pulp: 3,000,000 cubic meters	Machinery and equipment	None
Vostochnyy Port Construction Project	1971-76		Construction machinery	Buyer's credit: $100 million (including $20 million of local costs)
South Yakutian Coal Development Project	1975-2000	Yakutian coal: 84.4 million metric tons Kuznets coal: 20 million metric tons	Machinery and equipment and consumer goods	Buyer's credit: $450 million plus $135 million
Yakutian Natural Gas Exploration and Development Project	1976-	LNG: 7.5 million metric tons a year for 25 years (suspended)	Oil exploration equipment	Buyer's credit: $25 million
Sakhalin Continental Shelf Oil and Gas Exploration Project	1975-	Oil: not fixed LNG: not fixed	Oil exploration equipment, including ships, and consumer goods	Loans*: $185 million (oil exploration equipment), $22.5 million (ships) and $30 million (local costs)

*Indirectly financed by Export-Import Bank.

Source: Japan-Soviet Business Cooperation Committee and Sumiye O. McGuire, Soviet-Japanese Economic Relations (Santa Monica, California: Rand Corp., 1990), pp. 12-19.

In the superpower political arena the key word at that time was detente. The 1972 agreements between Washington and Moscow produced by the Strategic Arms Limitation Talks dispelled some Cold War constraints and provided Tokyo an opening to improve relations with Moscow. That also was a period in which Tokyo felt some political embarrassment from then President Richard Nixon's surprise 1972 visit to Beijing. As a result, Japan tried to initiate diplomatic action -- especially the normalization of relations with communist countries -- that was independent of Washington's policy line, yet not anathema to it. After establishing diplomatic relations with Beijing, then Prime Minister Kakuei Tanaka visited Moscow in 1973, the first Japanese prime minister to do so since the resumption of bilateral relations in 1956. Meetings with Communist Party head Leonid Brezhnev provided Mr. Tanaka with a hope that the territorial issue would be included on the agenda of peace treaty negotiations. This expectation led Tokyo to take a flexible stance concerning extension of official credits to the U.S.S.R., and that enabled Japanese businessmen to initiate the joint development programs.

Development Programs Suffer in the Early 1980s

The temperate climate for Japan-Soviet economic relations did not last long. Not only did Cold War tensions return but the gradual shift of Japan's manufacturing sector toward less energy-intensive high technology industries lowered concerns about finding new, dependable energy supplies. Ministry of International Trade and Industry data indicate that Japan's energy consumption in FY 1988 was only 45 percent higher than in FY 1970, even though the country's inflation-adjusted gross domestic product had more than doubled over this period. Moreover, after the first oil shock Japanese industry tapped new coal, oil and gas sources in Southeast Asia and China. The availability of lower cost supplies there compared to what potentially was obtainable in the Soviet Union led to a downward revision of Tokyo's estimates of the importance to Japan of Siberian and Soviet Far East natural resources. On natural gas, for example, Japanese importers concluded enough long-term supply agreements to more than cover projected Japanese demand through the end of this century.

Rising Cold War tensions also complicated Japan-Soviet relations in the 1980s. Washington imposed a series of economic sanctions against Moscow in response to its late 1979 invasion of Afghanistan and the Soviet's indirect oppression of Poland's democratic labor movement. The U.S. sanctions included suspension of new official loans, strengthened restrictions on high technology-related exports, including oil and gas drilling equipment, and limits on high-level government exchanges. When Tokyo followed Washington with similar economic sanctions, Moscow ignored Tokyo's claim to the Northern Territories to the point of insisting that there was no territorial dispute between the two countries.

As a result of this deterioration in the international and bilateral political atmosphere, many business transactions with the Soviet Union, including joint development projects, faced delay or even suspension. For example, no meetings were held between September 1979 and December 1984 of the Japan-Soviet business committee set up to review existing projects and to discuss future cooperative proposals. The Japanese government unofficially asked business leaders during the early 1980s to refrain from visiting Moscow as part of its effort to restrict high-level personnel contacts.

More important, the hold on Ex-Im Bank financing for new joint development projects made it hard to conclude new agreements. The two sides agreed to move ahead with only one new big resource development project in the 1980s, the second wood chip and pulp program, which was launched without the use of official credits. In addition, restrictions that kept U.S.-made oil exploration and drilling equipment from reaching Sakhalin Island delayed an offshore oil and gas exploration project there. The withdrawal of El Paso Natural Gas Co. and Occidental Petroleum Corp. from a trilateral gas development program in the Yakut district because of Washington's economic sanctions compelled Japanese firms to freeze negotiations with Moscow on this program, too.

Another bilateral resource development project cancelled because of international political concerns involved oil development in Western Siberia; the project was to include construction of a pipeline to the Pacific Coast. Beijing, fearful that the pipeline also would improve the Soviet military's capability to deploy in the China-Soviet border area, expressed its opposition to the project; that was its death knell.

Gorbachev's Reforms and the Impact on Bilateral Economic Relations

Beginning in the late 1980s Mr. Gorbachev sought to enact economic and political reforms. These initiatives have had various results -- such as helping to ease political tensions between East and West. The new cooperative attitude of the Soviet Union persuaded Washington to reduce its opposition to many kinds of high technology transfers. Of concern to Tokyo, however, was how far Mr. Gorbachev's "new thinking" reforms would go toward settling the Northern Territories issue. At the April 1991 summit meeting in Tokyo between Mr. Gorbachev and then Prime Minister Toshiki Kaifu, the Soviet leader formally acknowledged the existence of a dispute over the four islands -- a small but first step toward resolution of the issue.

Growing awareness of the deep problems in the Soviet economy colors current international and bilateral relations. In July 1991 Mr. Gorbachev essentially went hat in hand to seek immediate and long-term financial assistance from the leaders of the seven major industrialized democracies meeting in London. The two most cautious respondents were Japan and the United States. Questioning the wisdom of providing a large amount of financial help to the Soviet Union, the seven world leaders agreed to limit support to technical assistance and emergency food aid (see JEI Report No. 28B, July 26, 1991).

Some analysts argue that improvements in the international and the bilateral political climate ultimately will benefit Japan-Soviet business transactions because the political obstacles to trade, which had resulted in government controls on high technology exports and limits on official credits, have been reduced substantially. Other observers point out, however, that Tokyo will continue to be hesitant about supporting business deals until Moscow makes concessions on the territorial issue. Tokyo now is even more assured of the effectiveness of economic assistance as a bargaining chip for its territorial claim than in the Cold War era.

Private Sector's Concerns about Radical Change - Improvements in the international political atmosphere have not persuaded Japan's business community to overlook the confusion that has resulted from the rapid transformation of the Soviet Union's political and economic systems. Even before the country's

political situation began to degenerate quickly after the late August coup attempt against Mr. Gorbachev, corporate Japan was cool to eager Soviet entreaties for new business deals. For one thing, regulations designed to liberalize economic activities were changed frequently and left Japanese businessmen and others puzzled.

The recent accelerated dissolution of the Union of Soviet Socialist Republics is another reason for investors to wait to see what governing body finally will control the economic system. As an example of the current turmoil, many foreign businessmen now face difficulties in just finding an appropriate contact to handle negotiations. Until recently most business negotiations were conducted in Moscow with state entities, which monopolized trade with capitalist countries. Although tough negotiators from a business standpoint, officials of the former state trading organs typically had sufficient knowledge of trade with Western countries and proved to be reliable partners. Moreover, since state trading organizations controlled the distribution of products, they easily could handle countertrade arrangements. Representatives of these groups also were responsible for finding exportable products as a way of settling import bills from foreign countries without depleting the country's scarce foreign currency reserves.

In the current troubled political and economic climate most state trading organizations have been dissolved or have had substantial personnel turnover. Local governments and newly established private firms have begun to participate in trade and to ask foreign investors to conclude joint venture arrangements. Decentralization and privatization have raised concerns among representatives of foreign companies that these new, unfamiliar contacts will be naive about how market economies work and have little experience with foreign trade. Also of concern is that the Soviet Union's quality standards are insufficient for domestic products to be internationally competitive, despite the assumption at home that the goods will be sold easily. One fact-finding mission that visited the Soviet Union to review that country's progress in introducing a market economy raised the point that inspiring a business mentality among Soviet citizens well could be more difficult than rewriting economic regulations.

Several Japanese trading houses have set up representative offices in the Far East cities of Khabarovsk and Nakhodka; offices also are planned for Sakhalin. These offices, however, are designed mainly to collect information on the rapidly changing economic and political situation and to deal with the devolution of authority to local governments and private firms. Trading company officials do not expect to negotiate many business deals over the near term.

The Soviet sounding board that might have resolved some of the problems standing in the way of bilateral business deals, the counterpart to the Japan-Soviet Business Cooperation Committee, was left in disarray by the events following the failed August coup at the Kremlin. Many of the principal entities that took part in the Soviet-Japan Economic Cooperation Committee, such as the Soviet Chamber of Commerce and Industry, the Ministry of Foreign Trade and other ministries handling economic affairs, were ordered dissolved. Japanese committee members now are looking into the possibility of establishing a relationship with the Russian Republic's business community.

Soviet Economy and Bilateral Trade - The political confusion in the Soviet Union is not the only current obstacle to joint deals. So is a shortage

of hard currency to pay for imports needed now or in the future. Then there is the country's accumulated foreign debt; $500 million-plus in payments to Japanese exporters alone are overdue. Although the Ministry of International Trade and Industry had planned to provide export insurance to cover the overdue payments as a part of a $2.5 billion financial assistance package announced this fall (see JEI Report No. 39B, October 18, 1991), the recent dissolution of the Soviet central banking system has scrambled plans for this help.

The payment problem became obvious in the late 1980s. For a number of reasons Japanese exports to the Soviet Union always have fluctuated. The drop in annual shipments since 1988 has been linked to the payment problem. Last year Japan shipped to the Soviet Union about $2.6 billion worth of goods; that represented only 0.9 percent of Japan's worldwide exports. Machinery and transportation equipment comprised more than half of these sales (see Table 3).

Table 3: Japan's Major Exports to the U.S.S.R., 1990

(in millions of dollars; f.o.b.)

Product	Amount	Share
Food	$9.6	0.4%
Textiles and Apparel	146.5	5.7
Chemicals	273.5	10.7
Plastic Materials	134.4	5.2
Nonmetallic Mineral Manufactures	10.1	0.4
Metals and Fabricated Metal Products	469.0	18.3
Steel	376.4	14.7
Fabricated Metal Products	77.2	3.0
Machinery and Transport Equipment	1,339.6	52.3
Textile Machinery	95.9	3.7
Television Receivers	119.1	4.6
Videocassette Recorders and Tape Recorders and Players	105.9	4.1
Scientific and Medical Equipment	74.1	2.9
Motor Vehicles	113.6	4.4
Other	314.6	12.3
Total Exports	2,562.8	100.0

Source: Japan Tariff Association

Conversely, imports from the Soviet Union have grown fairly strongly since 1985. In 1990 Japan recorded a trade deficit with the Soviet Union for the first time in 15 years. Last year Japan bought nearly $3.4 billion worth of Soviet products, the equivalent of 1.5 percent of total imports. Most of this trade consists of industrial raw materials like logs, coal and nonferrous metal ores; few value-added products are represented (see Table 4). Much of the coal comes in under a long-term contract related to a joint southern Yakut coal mining project that started in 1975; coal shipments began in 1985 and will end in 2000. Japanese purchases of Soviet nonferrous metals, particularly gold,

Table 4: Japan's Major Imports from the U.S.S.R., 1990

(in millions of dollars; c.i.f.)

Product	Amount	Share
Food	$322.4	9.6%
Fish	310.7	9.3
Textile Fibers	34.4	1.0
Metal Ores and Scrap	61.9	1.8
Other Raw Materials	560.7	16.7
Logs and Lumber	521.9	15.6
Mineral Fuels	630.3	18.8
Coal	464.0	13.8
Crude Oil	10.2	0.3
Petroleum Products	155.7	4.6
Chemicals	62.6	1.9
Steel	276.1	8.2
Nonferrous Metals	1,001.4	29.9
Machinery and Transport Equipment	15.0	0.4
Other	386.2	11.5
Total	3,351.0	100.0

Source: Japan Tariff Association

platinum and palladium, have grown steadily in recent years. Some of these precious metals serve as substitutes for hard currency and are used to pay Soviet bills owed to Japanese exporters.

Joint Ventures - Moscow's economic restructuring plans envisioned various options. One saw foreign companies setting up joint ventures with Soviet firms to manufacture value-added products and export some of the output to the foreign partner's home market. Also conceived as a possibility was the privatization of state-owned firms, including those involved in the defense industry; these, too, were viewed as candidates for joint ventures. Soviet authorities also reportedly were prepared to set up foreign trade zones in several cities, including Nakhodka and Sakhalin in the Soviet Far East. Companies operating in the proposed FTZs would get some tax relief and tariff exemptions on imported products; in addition, currency exchanges would be unrestricted, a feature designed to attract foreign investors. The most radical Soviet economic planners stressed that market mechanisms, represented by free pricing and liberalization of private property ownership, soon would be introduced to the whole country.

Of the 34 known agreements concluded as of this past April between Japanese companies and Soviet entities (see Table 5), most involve small joint ventures in the lumber and fish processing areas or in the tourism sector. A majority of the companies are fairly new and have not begun operations. Of the 34 ventures, 22 are located in Eastern Siberia and the Soviet Far East; 10 are in Moscow.

Some analysts say that several of the incentives that Moscow is prepared to offer to attract foreign investors are similar to those already available in

Table 5: Selected Japan-Soviet Joint Ventures as of April 1991

(in thousands of rubles unless otherwise identified*)

	Business	Total Capital	Location
1.	Lumber mill	2,000	Irkutsk
2.	Sales of sporting goods	130	Moscow
3.	Fish processing	122.5**	Khabarovsk
4.	Salmon and trout hatchery	21,600	Yuzhno-Sakhalinsk
5.	Fish processing and sales	7,000	Yuzhno-Sakhalinsk
6.	Construction of hotels and restaurants	40	Moscow
7.	Transportation service	2,500	Moscow
8.	Passenger service at airports	200***	Moscow
9.	Fish processing and sales	3,000	Khabarovsk
10.	Rental car service	1,600	Moscow
11.	Construction of restaurant	680	Kholmsk (Sakhalin)
12.	Tourism development	1,000	Kholmsk
13.	Tourism development and construction of restaurant	150	Irkutsk
14.	Lumber mill	1,200	Khabarovsk
15.	Sales of agricultural goods	1,210	Moscow
16.	Fishing, fish processing and sales	500	Khabarovsk
17.	Design of office automation system	60	Moscow
18.	Fishing, fish hatchery and sales	1,000	Yuzhno-Sakhalinsk
19.	Publishing and cultural exchange service	30	Moscow
20.	Fishing, fish processing and sales	30**	Magadan
21.	Construction of restaurant	150	Khabarovsk
22.	Communications services for businesses	800	Khabarovsk
23.	Imports of office equipment and cameras and customer service	3,150	Kiev
24.	Production of electronics products	2,000	Moscow
25.	Construction of hotel and tourism development	5,400	Yuzhno-Sakhalinsk
26.	Transportation of goods and tourism development	1,250	Khabarovsk
27.	Foreign currency retail stores	300***	Khabarovsk
28.	Fish processing	1,000***	Vladivostok
29.	Recycling of steel scrap and sales	7,760	Khabarovsk
30.	Lumber mill	6,500	Tyumen
31.	Lumber mill	1,000	Khabarovsk
32.	Hamburger shop	950	Moscow
33.	Processing and sales of crabs and lobsters	1,500	Vladivostok
34.	Ship repair and trading	100**	Nakhodka

*Various exchange rates were used to convert rubles into dollars. For example, 1.8 rubles=$1.00 in most trade settlements, although the official exchange rate is 0.56 ruble=$1.00. On the black market $1.00 is equivalent to about 20 to 30 rubles.

**Millions of yen.

***Thousands of dollars.

Source: Nihon Keizai Shimbun, April 10, 1991.

the People's Republic of China and Southeast Asian countries. Compared to these places, the investment atmosphere in the Soviet Union is less attractive -- and will remain so even when new foreign investment regulations are in place, analysts argue. The Soviet Far East's main detractions for foreign investors will remain a shortage of labor -- especially skilled labor, a poor infrastructure and a harsh natural climate. Moreover, the uncertainty surrounding the Soviet economy undermines the value of the ruble, so that even if Soviet authorities suggest that foreign investors will be allowed to repatriate their profits by converting rubles into foreign currencies, they cannot control declines in the ruble's value. That prospect further discourages foreign investment.

Resource Development - Soviet authorities have placed much hope on attracting Japanese investors through the lure of natural resources in Siberia and the Soviet Far East. One Soviet economic planner offered a blueprint of regional development projects to Japanese businessmen at a joint economic committee meeting in January 1991. One proposal was the full-scale development of oil and gas reserves in Sakhalin and Yakut, a project that has been suspended since the early 1980s. The planner estimated that complete exploitation of the two fields would yield 840 billion cubic meters of gas and 80 million metric tons of oil. Pumping is expected to begin in 1995 and continue until 2015. Plans call for extending a pipeline underwater to Japan as well as overland to the Korean peninsula and possibly to China. The cost of the first phase of the project, which would concentrate on exploitation of Sakhalin's reserves, has been estimated to exceed $15 billion.

Several Japanese companies are interested in the project from a long-term viewpoint. Four of the six international consortia competing for oil development rights in Sakhalin include Japanese participants. Although Moscow initially intended to award the development rights by this past October, political conflicts between the central government and the local government delayed the decision. The government of the Sakhalin district reportedly asked Moscow to review the blueprint; it wants to include local infrastructure work, such as construction of roads and rail lines, plus agricultural development. Most likely the oil and gas project will remain stymied until the central authority issue is resolved. Further delay is possible as Russian Republic authorities work out terms with local district entities. Time, however, stands on Japan's side. Since current long-term agreements with other countries will cover Japan's natural gas requirements through 2000, companies there do not feel compelled to seek out supply sources in Sakhalin right now.

Tokyo's Assistance to Business - Loans from the Export-Import Bank as well as MITI's trade and investment insurance program serve to encourage Japan's private sector to engage in business with the Soviet Union. Without that type of support Japanese exports and participation in joint ventures would continue to shrink despite demand from Soviet citizens and industry eager to gain access to Japanese goods and technology. Although in the near term loans and insurance benefit Japanese exporters at least as much as Soviet importers, the Soviet side definitely benefits as well in the long term since trade with industrialized countries remains a key to gaining the technological expertise the Soviet Union needs to recover from its current economic difficulties.

Another area in which government can assist business in a foreign country is through technical assistance. Technical assistance over the long term -- especially in the area of fundamental management training -- could be vital

to introducing the workings of a market economy to the Soviet Union. Soviet factory managers have been invited to Japan by both the government and the private sector to gain an opportunity to see a market economy at work.

Whether or not Tokyo provides financial assistance on a major scale to the Soviet Union, or even something like foreign aid -- now reserved for developing countries, is a highly political issue, one related closely to progress on the Northern Territories dispute and in the peace treaty negotiations. Observers are certain that projects costing $10 billion and up, such as the Sakhalin oil and gas project, will not attract Japanese investors unless they get government support of some kind. Local infrastructure development also is considered a key project element. If a breakthrough occurs in the Japanese-Soviet, or Japanese-Russian, negotiations on a treaty to formally end World War II and if Tokyo decides to extend financial support for the Sakhalin and/or other Soviet Far East development programs, the prospects for additional Japanese investment certainly would improve.

The development of Eastern Siberia and the Soviet Far East has potential ramifications for the Soviet Union's other neighbors, including China and the two Koreas. Among the regional resource development proposals being studied is one calling for work in the Manchurian area of China bordering the Soviet Union and North Korea. If Tokyo and Pyongyang succeed in normalizing relations, Japan probably would participate in such a regional development project. Through economic assistance geared to the development of the Far Eastern region of Asia, Japan could play a major role in regional stability.

For further information, contact Tadashi Saito.

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The views expressed in this report are those of the author and do not necessarily represent those of the Japan Economic Institute.

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